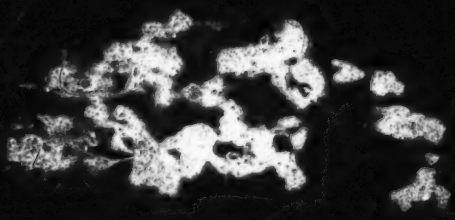

In the Supreme Court of the United States

OCTOBER TERM, 1967

No. 506

COMTEL CORPORATION, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

The primary question in this case is the proper characterization for federal income tax purposes of the sole transaction in which Comtel engaged during the seven-month period of its corporate existence. The Tax Court and the court of appeals found that the transaction, cast in the form of a sale and an option to repurchase, in substance and reality was a pre-arranged financing plan through which Comtel advanced Zeckendorf Hotels Corporation more than $8,000,000 and received more than $872,000 compensation in the nature of interest (R. 22a; Pet. App. 6b, 11b).[1] On the basis of this critical finding of fact, the

[1] "R." references are to the separately bound Appendix to Petitioners' brief in the court of appeals.

276-821—67

Tax Court rejected petitioners' contention that the transaction was a sale, and that Comtel's immediate distribution of the proceeds in liquidation qualified for the nonrecognition benefits of Section 337(a) of the Internal Revenue Code of 1954. The court of appeals, on the basis of its own exhaustive review of the record, affirmed.

The concurrent findings of the lower courts find ample support in the record and should be considered final here. There is no conflict of decisions or any other matter that warrants further appellate review.

1. In determining whether a transaction is a sale or a loan, the governing factor is, of course, the intention of the parties, and this is to be gathered not only from the instruments underlying the transaction but from all the attendant facts and circumstances. The facts and circumstances here justify—if not compel—the lower courts' conclusion that the transaction was in substance a loan. Zeckendorf at all times intended to "repurchase" the Commodore shares (R. 32a, 33a). These shares were subject to such restrictions as to their disposition by Comtel as to make their title in Comtel in all essential characteristics equivalent to a security transaction with Comtel and Zeckendorf as mortgagee and mortgagor, respectively (R. 35a, 93a–94a). Comtel sought profit not from the appreciation in value resulting from the operation of the hotel, but rather from the previously fixed "repurchase" price; the investors in Comtel were interested in a high yield, short term, risk-proof investment and not in owning or dealing in stock or managing hotels (R. 26a). To ensure the investors against loss on the transaction,

Zeckendorf was required to invest $633,000 of its own money in Comtel (R. 48a–49a) and to subordinate its right to repayment to prior payment in full of the investments of the other two shareholders, including interest at 6% and any expenses incurred (R. 33a, 56a–57a). Webb & Knapp, Zeckendorf's corporate parent, agreed to indemnify Comtel's shareholders against any loss, again including interest and expenses (R. 34a). The option was of short duration, and Zeckendorf could exercise it merely by paying a sum, the appearance of which is identical to interest and compensation for financing services on a purchase money mortgage (R. 16a–18a).

Virtually every argument advanced by the petitioners below, as here, focuses upon the "purchase" agreement of February 11, 1958 (R. 35a, 86a, 104a), under which legal title to the Commodore shares passed to Comtel. But this was only one of five agreements that the petitioners executed on that and the following day. In effect, Comtel would urge the Court to ignore the fact that each and every one of those agreements depended for its existence upon the existence of *all* the agreements and that the birth and demise of Comtel itself was the product of all the agreements. Through its concentration on the purchase agreement, Comtel has sought to divert the courts' attention from the entire financing arrangement which is comprised of the five interrelated agreements. It is the over-all effect of these documents upon which the answer to this case must be based, *United States* v. *Bethlehem Steel Corp.*, 315 U.S. 289, as the lower courts correctly ruled.

Petitioners are mistaken in their claim that the decision below, that there was a debt in the absence of a promise to repay, conflicts with the decisions of this and other state and federal courts (Pet. 6–9). Each of those cases turned on its own facts [2] and accordingly presents no conflicting issues of law.

[2] In two of the cases there was no proof that the transaction was different than evidenced by the formal conveyance and option to repurchase. *Glover* v. *Payn*, 19 Wend. 518; *Fullerton* v. *McCurdy*, 55 N.Y. 637. In *Youssoupoff* v. *Widener*, 246 N.Y. 174, and *Washmont Corporation* v. *Hendricksen*, 137 F. 2d 306 (C.A. 9), the courts held that the form of a transaction should have weight in determining the intention of the parties. In several of the cases the courts held the transactions to be illusory. *Autenreith* v. *Commissioner*, 115 F. 2d 856 (C.A. 3); *Bercaw* v. *Commissioner*, 165 F. 2d 521 (C.A. 4); *Gilman* v. *Commissioner*, 53 F. 2d 47 (C.A. 8). In *Bowersock Mills & Power Co.* v. *Commissioner*, 172 F. 2d 904 (C.A. 10), the court stressed, as we have done here, *supra*, that the whole pattern of agreements between the parties should be considered. In the following cases, in the presence of conflicting evidence, the courts found that the evidence supported the finding that an indebtedness existed. *Commissioner* v. *O. P. P. Holding Corp.*, 76 F. 2d 11 (C.A. 2); *Commissioner* v. *H. P. Hood and Sons, Inc.*, 141 F. 2d 467 (C.A. 1); *Campbell* v. *Carter Foundation Production Co.*, 322 F. 2d 827 (C.A. 5). In others, the evidence supported findings that no indebtedness existed. *Randall* v. *Sanders*, 87 N.Y. 578; *Jewel Tea Company, Inc.* v. *United States*, 90 F. 2d 451 (C.A. 2); *Sherwood Memorial Gardens* v. *Commissioner*, 350 F. 2d 225 (C.A. 7); *Thompson* v. *Commissioner*, 235 F. 2d 599 (C.A. 9). *Guardian Investment Corp.* v. *Phinney*, 253 F. 2d 326 (C.A. 5), is clearly inapplicable, holding as it does that an accrual basis taxpayer can deduct interest only in the year when he becomes obligated to pay it. The petitioner cites also *Deputy* v. *du Pont*, 308 U.S. 488, 497–498 (Pet. 7), for definitions of "indebtedness" and "interest". There is nothing in the decisions of the lower courts which offends these definitions, which were correctly applied to the complex facts here.

Here, the lower courts looked through the form of the transaction as created by the draftsmen of the agreements and found that the practical circumstances underlying the transaction were such that Zeckendorf was effectively compelled to exercise the option (R. 28a; Pet. App. 12b). The exercise of the option was the only way for Zeckendorf to protect its $633,000 investment in Comtel, which had been subordinated to the interests of other stockholders; to protect its parent, Webb & Knapp, against a larger potential liability under the latter's agreement to indemnify the other stockholders; and to avoid losing the benefit of its own efforts and expenses in acquiring the Commodore stock from the public shareholders and in negotiating the financing transaction. Thus, even in the absence of an unconditional legal obligation to pay money, the lower courts were fully justified in characterizing the transaction as a loan as opposed to a sale. The "essence" of arrangements "is determined not by subtleties of draftsmanship but by their total effect." *Commissioner* v. *P. G. Lake, Inc.*, 356 U.S. 260, 266–267.

2. The court of appeals did not, as petitioners claim (Pet. 9–18), err in refusing to consider their contention that if the transaction amounted to a loan there would be no interest income but rather a tax-free original issue discount. Petitioners have throughout this litigation been represented by the same competent counsel. Their contention was made for the first time in a single paragraph of a lengthy appellate brief and without citation of authority. Petitioners in substance

argue that, whatever the circumstances, a court of appeals is obliged to consider any and every legal theory asserted on appeal but not at the trial level. But the courts of appeals plainly have discretion to refuse to entertain such arguments. *Hormel* v. *Helvering*, 312 U.S. 552. The Second Circuit just as plainly exercises that discretion according to the dictates of the particular circumstances of an individual case, as is demonstrated by the other Second Circuit cases—decided both before and after the present case—that petitioners cite (Pet. 14–15). The court of appeals in this circumstances, justifiably declined to consider the "bare bone explication" of this "novel contention" (Pet. App. 17b).[1]

[1] This "novel contention" is in any event without merit. Section 1232 of the 1954 Code classifies as a sale or exchange the redemption of certain debt instruments. The question sought to be raised by the petitioners is the meaning of the word "property" in Section 337(a). Section 1232 does not define "property" for purposes of Section 337. See *Central Building & Loan Assn.* v. *Commissioner*, 34 T.C. 447; cf. *United States* v. *Midland-Ross Corp.*, 381 U.S. 54. See also Section 337(b). So far as our research reveals, petitioners' contention has not been raised in any other reported case and does not constitute a problem of importance in the administration of the tax laws. Moreover, this issue does not warrant review by this Court here because of the unique factual context in which it is raised.

The petition for a writ of certiorari should be denied.

Respectfully submitted.

RALPH S. SPRITZER,
Acting Solicitor General.
MITCHELL ROGOVIN,
Assistant Attorney General.
CROMBIE J. D. GARRETT,
ELMER J. KELSEY,
Attorneys.

SEPTEMBER, 1967.

U.S. GOVERNMENT PRINTING OFFICE, 1967